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PRIVATE OR MARKET ECONOMY IN BULGARIA? AN INSTITUTIONAL APPROACH TO THE BULGARIAN TRANSITION

The transition to a market economy in Bulgaria is a complex process that requires the privatisation of the economy. But, privatisation is not enough. Transition means a deep institutional change that has to do with the transformation of the behaviour economic agents. This article analyses the Bulgarian transformation from an institutionalism approach, focusing in the transformation developed in the sphere of means of production. The analytic framework presented allows evaluating the degree of installation of market relations in this sphere. In Bulgaria, a breakdown exists between the installation of formal market institutions and the creation of market relationships in this sphere, which have been developed not completely.
JEL: P20, P26, P23, P31

Introduction

The expected outcome of the economic transition that has been unfolding in Bulgaria since 1989 is the construction of a market economy. This result has always been a necessary condition for integration of the country into the European Union (EU). The negotiating process is now concluded, the European Commission has confirmed that Bulgaria has an operating market economy[2] and Bulgaria could join the EU in 2007. Such has been the evaluation of Bulgaria's economic reforms as made by the EU.

The evaluation of economic policies of structural reform under transitional conditions is not a simple task. One approach consists of examining the degree of implementation of the typical formal institutions of a market economy. This type of analysis allowed Aslund, for example, to conclude in 1995 that Russia had already become a market economy[3]. Nevertheless, from a Polanyian approach, the results of the transition will not necessarily lead to the creation of market economies. The elimination of planning institutions, the decentralisation of economic decision making and the creation of the typical institutions of a market economy (lifting of price controls, privatisation, etc) do not guarantee such results.

This study has a double objective. The first is to contribute to the establishment of a mechanism that permits the evaluation of the effectiveness of economic reform policies in a transitional period beyond merely analysing the formal changes. The

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[2] EC (2003a): *2003 Regular Report on Bulgaria's Progress Towards Accession*. Commission of the European Communities, Brussels.

[3] Aslund, A. (1995): *How Russia Became a Market Economy*. Brookings Institution, Washington, D.C.

second is to determine the degree of extension of market relations in the field of the means of production in Bulgaria, because the marketisation of these factors of production, as well as the others that facilitate economic production, is a necessary condition for the construction of a market economy. This article is organised as follows. The first part presents a methodological framework that permits the interpretation of the construction of a market economy as a process of institutional change in terms of Polanyi. Next, sections from 2 to 4 analyse the structural transformations generated by the privatisation (section 2), the liberalisation and the development of bankruptcy (section 3) and the changes in the financial sector (section 4). Finally, the concluding section assesses the economics reforms by checking the degree of fulfilment of the criteria for installation of markets.

1. Market economy and marketisation of the means of production. A mechanism for evaluating reforms based on the institutionalism of Polanyi

According to the orthodox approach, defended by authors such as Aslund[4], Brada[5], Lipton and Sachs[6], Blanchard et al.[7] or Fischer[8], the elimination of central planning and the creation of institutions characteristic of a market economy will cause the appearance of such an economic system for the allocation of resources. However, this approach has been broadly questioned by authors like Andreff[9], Murrell[10], Roland[11], Ellman[12], Stark[13] or Lavigne[14], who have contributed to criticisms of the orthodox approach, from the perspective of the transition being understood as an institutional change that has to do with the transformation of the behaviour of the agents and economic organisations.

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4 Aslund (1995): op.cit. and Aslund, A. (1994): "Lessons of the First Four Years of Systemic Change in Eastern Europe", *Journal of Comparative Economics,* 19, 1.

5 Brada, J. (1993): "The Transformation from Communist to Capitalism: How Far? How Fast?", *Post-Soviet Affairs,* 9, 2 and Brada, J. (1996): "Privatization Is Transition –or Is it?", *Journal of Economic Perspectives*,10, 2.

6 Lipton, D. and Sachs, J. (1990): "Creating a Market Economy in the Eastern Europe: the case of Poland", *Brookings Papers on Economy Activity*, 1.

7 Blanchard, O., R. Dornbush, P. Krugman, R. Layard and L. Summers (1991): *Reform in Eastern Europe*. MIT Press, Cambridge, MA.

8 Fischer, S. (1993): "Socialist Economy Reform: Lessons of the First Three Years", *American Economic Journal*, 83, 2.

9 Andreff, W. (2003): *La Mutation des Économies Postsocialistes. Une Analyse Économique Alternative*. L'Harmattan, Paris.

10 Murrell, P. (1992a): "Evolutionary and Radical Approaches to Economic Reforms", *Economics of Planning*, 25, 1, Murrell, P. (1992b): "Evolution in Economics and in the Economic Reform of Centrally Planned Economies", in Clague, C. and Rausser, G. (eds), *The Emergence of Market Economies in Eastern Europe*. Blackwell, Cambridge, Murrell, P. (1993): "What is Shock Therapy? What Did it Do in Poland and Russia?", *Post-Soviet Affair,* 9, 2 and Murrell, P. (1996): "How Far Has the Transition Progressed?", *Journal of Economic Perspectives*, 10, 2.

11 Roland, G. (1993): "The Political Economy of Reestructuring and Privatisation in Eastern Europe", *European Economic Review*, 37, 2/3.

12 Ellman, M. (1994): "Transformation, Depression and Economics: Some Lessons", *Journal of Comparative Economics*, 19, 1.

13 Stark, D. (1998): "Path Dependence and Privatization Strategies", in Stark, D. and Bruszt, L. (eds.), *Postsocialist Pathways. Transforming Politics and Property in East Central Europe*. Cambridge University Press, Cambridge.

14 Lavigne, M. (1997): "Central European Countries: Balance Sheet of a Stabilization", *Cuadernos del Este*, 20.

A Polanyian perspective of the transition (March and Sánchez[15] and De Arriba[16]) challenges the chain of causal relationships that leads from the elimination of the institutions of centralisation to the decentralisation of decision making, and from there to exchanges being governed by profit and, finally, to the market. In fact, the possibility exists for developing forms of economic integration different from exchange, such as reciprocity and redistribution, that could create institutional models distinct from the market[17]. On the other hand, the existence of markets doesn't necessarily guarantee the appearance of market economies. This outcome depends on additional conditions. It is necessary, on one hand, that profit becomes the driving motivation for making economic relationships and that the survival of individuals depends on their participation in the market[18]. Production factors are the essential elements of economic reproduction and, therefore, of the survival of individuals. As a consequence, it would be necessary that production factors should be subject to market relationships and that they are auto-regulated and interconnected. Therefore, the creation of a market economy would demand the marketisation of those spheres characteristic of economic reproduction, that is to say, the means of production, land and labour.

To determine the degree of installation of the market in each one of the relevant spheres and to evaluate the effectiveness of the reforms, it is necessary to define the concept of market. The existence of markets demands the fulfilment of the following conditions[19]:

1. That the exchange be possible.
2. That the price be determined within the framework of the exchange.
3. That the exchange be auto-regulated by the price.
4. That this integration mechanism be dominant.

In transitional economies, such as Bulgaria's, obstacles exist to the creation of markets beyond the realisation of changes in the formal institutions. The resistance to change shown by the informal institutions as well as the reaction of agents towards the new institutional universe could explain these limits. As a consequence, the structural economic policies characteristic of a transitional process can generate a hybrid institutional framework resulting in a mixture of relationships of exchange, redistribution and reciprocity.

By contrasting the degree of fulfilment of the mentioned conditions, the effectiveness of economic policies of structural change under conditions of transition towards a market economy can be evaluated. The four general conditions have to be fulfilled with respect to each of the production factors (means of production, land and labour) in the analysed economy. In this way, it is possible

[15] March, J. M. and Sánchez, A. (2000): "La Construcción de Instituciones de Mercado: Utopía y Realidad en el Caso Ruso", in March, J. M. and Sánchez, A. (eds.), *Política Económica y Límites Estructurales en la Transición Rusa*. Universidad de Valencia, Valencia and March, J. M. and Sánchez, A. (2002): "The Construction of Market Institutions in Rusia: A View from the Institutionalism of Polanyi", *Journal of Economic Issues*, 36, 3.

[16] De Arriba, R. (2001a): *Transición hacia una economía de mercado: políticas económicas estructurales y cambio institucional en Bulgaria*. Ph.D. Dissertation. Universidad de Valencia, Valencia.

[17] Polanyi, K. (1957a): "The Economy as Instituted Process", in Polanyi, K., Arensberg, C. M. and Pearson, H. W. (eds.), *Trade and Market in the Early Empires*. The Free Press, Glencoe, Ill.

[18] Polanyi, K. (1957b): *The Great Transformation*. Boston: Beacon Press.

[19] Polanyi, K. (1957b): op.cit., March, J. M. and Sánchez, A. (2002): op.cit. and De Arriba, R. (2001a): op.cit.

to evaluate the effectiveness of the program of economic reforms and the institutional transformation that is really happening in the economies in transition.

This paper contributes to the analysis of the extension of the market relations in one of the key spheres, the means of production. To evaluate the degree of installation of markets in this concrete field it is necessary to set specific validation criteria that allow an assessment of the general conditions of definition of markets (Table 1). In the first place, the exchange possibility requires the existence of economic agents participating in it without restrictions as well as fully available means of production. The confirmation of the first condition leads to the analysis of the privatisation of the property rights of the means of production. In the second place, the price has to be determined in the sphere of the exchange, that is to say, by those who participate in it. The specific validation criteria are the decentralisation of the economic decisions and the liberalisation of prices.

Table 1

Specific criteria of marketisation of production means

General Conditions	Specific Criteria
1. the exchange is possible.	1. **Privatisation**.
2. prices determined by the exchange.	2. **Decentralisation** and **liberalisation**.
3. prices auto-regulate the exchanges.	3. **Bankruptcy** and **financial system.**
4. this mechanism is dominant.	4. **Degree of extension of this mechanism**.

According to the third condition, price should become the regulatory mechanism of exchange. The means of production are a special commodity. In fact, they are not only incorporate tangible components, but also intangible components, such as organisational and managerial capital. The decisions of demanders and suppliers of the means of production should be determined by economic viability. The existence and use of the means of production must depend on the profitability in a context of the tightening of budget constraints. If their use does not generate profits, they lose their value for possible demanders and their use would have to change; if they generate profits, they acquire value and they subsist. The analysis criterion of this third condition leads to the study of the financial system and the regulation of the bankruptcy.

Bankruptcy has a double function. On one hand, it allows the liberation of resources in non-profitable uses that feed the supply of the means of production for other uses and, on the other hand, it guarantees that the existence of enterprises is determined by their profitability. As a consequence, bankruptcy contributes to an allocation of resources carried out through the market and it imposes financial discipline on the debtor. Moreover, it encourages the restructuring of the viable enterprises with liquidity problems and stimulates the credit, protecting the creditors, which contributes to the development of banking activity[20].

Taking a look at the financial system, a fundamental responsibility is the monetisation of the economy. Exchanges must be carried out in currency because the extension of the barter, non-payment and the cancellation of debts limit the regulatory function of price. Secondly, the financial system has to link the value of the means of production to its profitability through the capital markets and through

[20] Pistor, K. (2000): *Patterns of legal change: shareholders and creditor rights in transition economies*. EBRD Working Paper nº 49. EBRD, London.

the allocation of credit, by tightening budget constraints. This way the financial system establishes the distinction between profitable enterprises and loss-making ones. Thirdly, it furnishes financial resources for the demand and use of the means of production. And fourthly, the financial system controls the management of the means of production through the capital markets, the allocation of the credit and the participation in the property.

Lastly, according to the fourth condition, this kind of exchange self-regulated by prices has to be the main integration mechanism. It would be necessary to determine its degree of extension.

2. Privatisation

The construction of a market economy needs a change in the structure of the ownership of the means of production through which private property becomes the predominant form. The privatisation process developed during the transition in Bulgaria consists of a mixture of all the existent methods of transformation of the property of assets, that is to say, spontaneous privatisation, restitution of property, privatisation from below, mass privatisation and cash privatisation.

The privatisation has happened in a context of economic, social and political crisis. The socio-political constraints evolved from the struggle between new and old elites and other groups seeking a power position in the new social order. The economic crisis was a consequence of the collapse of the planned economy and increased with the start of reforms. The crisis manifested itself in the contraction of production, hyperinflation, unemployment, reduction of real wages and external debt[21].

Privatisation in Bulgaria was a huge and complex task. At the beginning of the transition, Bulgaria had an extensive industrial sector which represented approximately 60% of the GDP. In addition, the private sector was practically nonexistent. The share of state property in the industry was about 95%. The companies were very big. About 20% of the companies had more than 5,000 workers and 2/3 counted more than 1,000 employees. Only 5% of the companies had less than 200 workers. The production structure responded to the Soviet industrialisation model and the international division of the labour in the framework of the CMEA exchange system. There was a high concentration of industries with low added value, the companies were vertically integrated and they presented a strong segmentation of activities, including those of a social character and function (e.g. apartments, health services, schools, kindergarten). With the disintegration of the old institutions this industrial structure lost its coherence. A great number of these companies made constant losses and were heavily in debt. Under market conditions, their profitability would have been more than doubtful and their competitiveness was low, considering the obsolescence of the capital endowment and the high need for inputs[22].

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[21] De Arriba, R. (1998): "Límites estructurales en el inicio de la reforma económica en Bulgaria", en *Quaderns de Política Econòmica*, 20.

[22] In the end of 1991, half of the state companies made losses. (See OCDE (1992): *Bulgarie: évaluation de la situation économique*. OCDE, Paris). The following year, only 21.7 % of the state companies covered all costs. (See IMF (1999): *Bulgaria: Recent Economic Developments and Statistical Appendix*. IMF Staff Country Report nº 99/26. IMF, Washington). This delicate financial situation reduced the chances to successfully privatise these companies.

2.1. Stages of the privatisation process

The Bulgarian privatisation process has seen four different periods since 1989. In the first period from 1989 to 1992 first steps of the process were initiated through economic decentralisation. This process had already started with the Ordinance nº56 of January 1989 on Economic Activity and was followed by the demonopolisation and liberalisation of the economy, mainly since February 1991. In this first stage some kind of spontaneous (pseudo-legal or illegal) privatisation developed and also the restitution of land and urban properties begun[23]. The essential conditions for the development of a private sector were established too, through the elimination of the planned economy and economic liberalisation.

The second period can be placed in the time between 1992 and 1996. In February 1992 the Privatisation Law was adopted but it took almost one year to complete the privatisation legislation. This Law envisaged the transformation of all state enterprises into commercial companies which had to be sold by the traditional case by case method as a whole entity. As privatisation met with a lot of obstructions from the politicians, state managers, employees and civil servants only few transactions were completed. In June 1994 the Privatisation Law was reformed, introducing new elements as the idea of mass privatisation and the preferential scheme for purchase of companies by its managers and employees (the managers and employees buy-outs or MEBO system). At that time the socialist government was not very keen on developing large scale privatisation. In this period, mainly small scale privatisation achieved some progress. In an attempt to boost privatisation the socialist government started preparation for mass privatisation in 1995 and in 1996 the first wave was launched. By the end of 1996 Bulgaria experienced a deep financial crisis which was followed by new elections and introduction of a currency board system[24]. Between 1993 and 1996, the 10.84% of the state assets for privatisation were privatised[25].

The third stage, from 1997 to 2000 could be considered as a real development in privatisation. The economic reforms are characterised by the setting in operation of the currency board and the close supervision by the IMF. The first wave of mass privatisation was finalised by mid 1996 and preparation for the second wave started. Big changes were made in all privatisation legislation to speed up and facilitate the process. The government opened the financial sector for privatisation and state agencies became more active in searching for foreign investors. Looking at quantitative outcomes, over that period privatisation achieved certain success. However, at the same time public opinion and support towards privatisation declined due to the corruption, big public scandals and poor functioning of public agencies dealing with privatisation. The activity in the period 1997-2000 was intense and 66.96% of the state assets for privatisation were privatised[26].

The fourth stage begins in 2001 and saw new government changes in the Privatisation Law with the intention of giving a new impulse to the privatisation process. This period is characterised by the start of the privatisation of the state

[23] Keremidtchiev, S. (1993): "Les premiers pas de la privatisation en Bulgarie", *Revue d'études comparatives Est-Ouest*, 3-4.
[24] See Section 4.
[25] Privatisation Agency (2006): *Summary Report over the Privatisation Process in Bulgaria as of November 30, 2004*. www. priv.government.bg. Visited 15/02/2006.
[26] Privatisation Agency (2006): op.cit.

monopolies in the sectors of telecommunications (Bulgarian Telecommunication Company, BTK), energy, transports and others as Bulgartabac[27]. This period is also marked by the introduction of the legal changes linked to the pre-accession strategy of Bulgaria for membership of European Union. In 2002 the Privatisation and Post-Privatisation Control Law is approved with the objective of introducing more transparent rules for all participants in the privatisation, and equal treatment and faster privatisation process. In this way, the main privatisation methods would be open public tenders and public auctions at the Privatisation Agency. The method of negotiations with potential buyers, very criticised, was abolished. This law also strengthened post-privatisation control through setting up an Agency for Post- Privatisation Control[28].
In 2003, the strategy changed in order to improve transparency and to speed the process through a broader use of the Bulgarian Stock Exchange (BSE), through public offers or public auctions. This way, 78% of all the sales after Post-Privatisation Law was approved were made through BSE. These changes supposed an important acceleration of the privatisation process and the predominant use of public auctions achieved maximum prices for the assets sold. Between 2001 and 2004, the 9.14% of the state assets for privatisation were privatised[29]

2.2. Cash privatisation and development of the legislation.

The Transformation and Privatisation of State-Owned and Municipal-Owned Enterprises Law (Privatisation Law) was adopted in 1992, followed by various modifications. The main objectives were to eliminate the chaos in the privatisation process, the suppression of spontaneous privatisation and the achievement of as many sale proceedings as possible. This law regulated the whole privatisation process defining the different organs and their responsibilities, the type of companies to be privatised, the terms of participation with preferential conditions, the methods of valuation and the sale methods. Any individual or organization, where the state or the municipality did not possess more than 50% participation, could participate in the privatisation process. However, the law established preferential mechanisms of purchase for some lessees, employees and managers and the possessors of public debt titles. The preferential conditions included the possibility to pay in instalments 90% of the payment for 10 years and to enjoy 50% discount form the real interest rate. The preferences were applicable only in case that at least 20% of the state company's staff set up a special buy-out company.

[27] See AEAF (2003): *National Economic Development Plan of the Republic of Bulgaria over the 2000-2006 Period. Update June 2003*. Adopted by CoM on 5 June 2003. Agency for Economic Analysis and Forecasting, Sofia. In March 2003, 2 district heating distributors were privatised, the majority stakes in the seven regional electricity distribution companies were privatised at the end of 2004 and three hydro-plants were sold also in may 2004, in the context of the privatisation of the energy sector. In February 2004 the privatisation of the BTK was completed with the purchase by Alive Ventures (Austria) of 65% of shares for 230 million Euro. The other 35% was sold on the BSE in January 2005.
[28] Even before of the new government's arrival in 2001 the MEBO privatisation methods and the mass privatisation were abandoned and the Center for Mass Privatisation closed in 2000. See De Arriba, R. and Keremidchiev, S. (2005): "Lessons Learnt from the Privatisation in Bulgaria", *EACES Workshop "Privatisation in Serbia: Experience and Lessons from other Transition Countries*. Belgrade, 14-15 September 2005.
[29] Privatisation Agency (2006): op.cit.

The managers and employees buy-outs (MEBO) were developed after the modification of the privatisation law in 1994 and they constituted one of the main ways to transfer state property. The privatised companies were small and medium sized and not very attractive. The price was low and the purchases were financed with credits guaranteed by the assets of the company and future profits[30]. In most of the companies, the managers took control[31]. Foreign investors were another agent in the Bulgarian transition. Although the number of transactions was not very high, they bought almost all of the biggest state companies. Indeed, between 1993 and 2004 there were 163 privatisation agreements with foreign investors[32].
The cash privatisation process has been very difficult. The privatisation developed in a climate of constant political tensions, government's changes, modifications of the legal framework and numerous conflicts among the different organs about responsibilities. The agents involved in the process, ministries and managers and employees of the companies, showed resistance to losing their special positions. Peev states that the main reason for slow progress of the privatisation process during the nineties was the fight for corporate control between different groups of interest and new "crony firms" [33]. Another reason was the nature of the companies to be privatised. Not many attractive companies existed; few were profitable, most of them highly in debt and very big. The economic framework had changed completely compared to the old system which was characterised by the extensive growth and the intra-CMEA trade. In case of the highly indebted companies the sale was carried out at a very low price, on condition that the buyer assumed the debts[34].The unclear legal status of the companies aggravated the situation. Many documents as to the legal ownership of assets and buildings were missing. In addition, the limits between state and municipal property were not clarified. This generated conflicts among different administrative bodies[35].

2.3. Mass privatisation

The adoption of a strategy for allocation of the state assets among the population was motivated by the slow progress of privatisation. The programme was developed into two stages[36]. Each Bulgarian citizen older than 18 years had the right to buy a voucher for the price of 500 (old) leva that represented an investment value of 25,000 (old) leva. During the first phase, the vouchers could only be used to buy shares of the companies that were explicitly offered in the program. Every

[30] World Bank (2000): *Review of Bulgarian Privatization of Large Enterprises*. The World Bank Resident Mission in Bulgaria, Sofía.
[31] See Michailova, S. (1997): "The Bulgarian Experience in the Privatization Process", *Eastern European Economics*, May-June and Alexandrova, S. (1999): "Enterprise Perfomance and Corporate Governance", Dimitrov, M.; Andreff, W.; Csaba, L. (eds.): *Economies in Transition and the Variety of Capitalisms*. Gorex Press, Sofia. The slowness of the restructuring process in this type of companies after the privatisation caused the World Bank to even recommend the nationalisation of these assets. See World Bank (2000): op.cit.
[32] Privatisation Agency (2006): op.cit.
[33] Peev, E. (2002): "Ownership and Control Structures in Transition to "Crony" Capitalism. The Case of Bulgaria", *Eastern European Economics*, 40, 5.
[34] An example of this possibility was the privatisation of the company Kremikovtsi, the jewel of the Bulgarian metallurgy, which was sold for only one dollar.
[35] Moser, C. A. (1994): *Theory and History of the Bulgarian Transition*. Free Initiative Foundation, Sofía.
[36] For a more detailed description see Tchipev, P. (2003): "Bulgarian Mass Privatisation Scheme. Implications on Corporate Governance", *Journal of Economic Studies*, 30, 3/4.

citizen in possession of such a voucher could participate directly in the process of acquisition of state company shares or indirectly through a privatisation fund[37]. Throughout the first wave, vouchers for 75,000 million leva were emitted, representing about 16% of the long term state assets. By the end of the auctions of 69.1 million shares, 76.4% of those offered initially were transferred. From 6.5 million Bulgarians holding the right to participate in the programme, 3.5 millions became shareholders. 500,000 got directly involved and 3 millions gave their vouchers to the privatisation funds that acquired almost all the offered shares[38].

For the second phase, beginning in July 1998, the government introduced some modifications with support from the IMF, since the privatisation funds did not contribute new capital for the restructuring of the companies[39]. Legislative changes introduced the vouchers as a means of payment in a larger amount of operations (e.g. bids of company repurchase operations by managers and employees of the company or pension funds). However, this time they could not be transferred to a privatisation fund. This restriction caused more modest results. In June 1999 only 976,000 people participated in the programme, 15.2% of all eligible persons. Accordingly, less than 60% of the offered shares were purchased[40].

Two of the objectives of the mass privatisation programme, among others, were to speed up privatization and to stimulate the development of the middle class[41]. Undoubtedly, mass privatisation contributed to the extension of private property. Concretely, through the Center for Mass Privatisation the 22% of the state assets for privatisation was privatised[42]. However, regarding the important big companies, the programme offered only up to 33% of their assets, allowing the state to maintain control. The state lost control and its veto right on strategic decisions only in about a third of all offered companies.

Another objective which met with little success was the creation of a broad middle class as main economic agent characteristic of a market economy. Indeed, the population did not show strong interest in entering into ownership of a reduced part of state company shares. The population lacked appropriate information on the companies and there existed doubts about the possibilities of obtaining benefits by participating in the programme. Despite the promises of the mass privatisation programme, the offered companies were not very attractive, which could explain the lack of interest among the population to obtain shares. It was a limited number of privatisation funds which acquired almost all the transferred assets. Mass privatisation produced the creation of only 81 privatisation funds and the concentration of the vouchers in a reduced number of them. About 75% of the vouchers were distributed among the 18 main funds[43]. New relationships arose among the managers of the companies and the directors of the funds. While the

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[37] Center for Mass Privatisation (1995): *Program for privatization through investment vouchers*. Center for Mass Privatization, Sofia.

[38] CSD (1999): *Bulgaria's capital markets in the context of EU accession: a status report*. Center for Study of Democracy, Sofia.

[39] IMF (1999): op.cit.

[40] Miller, J. B.; Petranov, S. (2000): "The first wave of mass privatization in Bulgaria and its immediate aftermath", *Economics of Transition*, 2, 1.

[41] Tchipev, P. (2003): op.cit.

[42] Privatisation Agency (2005): *Information about the Privatisation Process in Bulgaria as of 31.08.2005*. www. priv.government.bg. Visited 09/09/2005.

[43] Miller, J. B.; Petranov, S. (2000): op.cit.

directors of the funds allowed the managers to maintain their position, the company directors provided privileged information or offered the employees' vouchers to the funds. The funds belonging to financial institutions and banks provided privileged credits to their companies. However, the privatisation funds contributed generally very little new capital for the restructuring of their companies. The funds' strategy was to take over control of the companies by buying more shares after the auctions[44]. Almost 90% of the transactions were made in blocks of shares, purchased with the intention to create share majorities[45].

2.4. Outcomes

At the end of 2004 the privatisation process had almost finished. Private sector in Bulgaria represents about 75% of the GDP. According to official data from the Bulgarian Privatisation Agency, by August 2005 assets privatised amount to 58.96% of the state-owned assets (580 millions BGN) or to 89.29% of the state-owned assets due to privatisation. Between 1993 and august 2005 stakes and shares of 5222 enterprises (2910 entire enterprises and 2312 self-contained facilities) have been sold. Also, some 3915 minority or residual packages unsold after the initial privatisation agreements were divested[46]. The state still keeps shares and stocks in 770 companies, including majority packages (more than 50%) in 62 and minority packages in the others 533 (of which 301 are for restitution claims)[47]. At the beginning of 2005, there are still left to be privatised the tobacco state monopoly (Bulgartabac), energy sector, transport sector (Bulgarian River Shipping Company, Bulgarian Maritime Shipping Company and Bulgaria Air), some military-industry companies and the state minority shares in enterprises already sold[48]. Also, there are 113 companies on the list of companies exempt from privatisation according to the Post-Privatisation Law.
After enterprise privatisation there has been little change in the management of the companies. The reasons have to do with the influence of the traditional powers, such as unions, political elite and local communities that conserve considerable power to defend their interests, many times associated with the former management[49]. One of the deficiencies observed after the processes of privatisation of the companies is the domain of the management by insider agents[50] and the limited role that the foreign investors have played, compared with

[44] CSD (1999): op.cit.
[45] Tchipev, P.; Dragneva, R. (1999): "Mass Privatisation Funds – the New Institutional Investors in the East? A Comparativa Study of CEE Mass Privatisation Schemes", en Dimitrov, M.; Andreff, W.; Csaba, L. (eds.): *Economies in Transition and the Variety of Capitalisms*. Gorex Press, Sofía.
[46] According to the Bulgarian Privatisation Agency, the transfer of 51% of the assets of a company means its privatisation. However, the IMF considers that the privatisation of the state companies means the transfer of property from the State to the private sector, implying the transfer of the right to make the strategic decisions, including the reduction of the size, the liquidation or the increase of the capital (See IMF (1999): op.cit.). It demands the elimination of the possibility of blocking this type of decisions by the State. According to the Bulgarian Commercial Law of 1991, the owner of 33% of shares of a company can block the decisions. This means that one could not speak of privatisation in their full sense below the transfer to the private sector of 67% of the assets of the company.
[47] Privatisation Agency (2005): op.cit.
[48] Privatisation Agency (2006): op.cit.
[49] World Bank (2000): op.cit.
[50] World Bank (2004): *Building Market Institutions in South Eastern Europe. Comparative Prospects for Investment and Private Sector Development*. World Bank, Washington.

other transition economies of Central Europe. Especially in enterprises with high dispersion of property, the company managers on many occasions don't subordinate their strategy and obligations to the interests of the proprietors/shareholders. This behaviour usually goes even accompanied with the withholding of important information to the proprietors. Attempts to discipline the managers by means of linking their remuneration to the company benefits are not always effective. Legal economic incentives are less effective than other mechanisms often formed outside of the framework of the legal economic practice. Even in companies with high concentration of ownership and without separation between property and control, sometimes owner objectives are not directed to the development of the enterprises but rather to their short-term use according to asset-stripping strategies[51]. The representatives of the State in the management team abuse, in many occasions, their position as state representative beyond their power as shareholder. On the other hand, the state intervention in the private companies generates a climate that favours the establishment of informal obligations between companies and the introduction of political elements in the economic decisions. The attempt to overcome these limitations was one of the motives behind the creation of the Post-Privatisation Control Agency, the abolition of the MEBO method and the use of the competitions and tenders like the methods to sell the state assets.

3. Decentralisation, Liberalisation and Bankruptcy

3.1. Decentralisation and Liberalisation

The first signs of decentralisation of the big state holdings became visible with the promulgation of the Ordinance nº56 of January 1989 on Economic Activities. The Ordinance conferred independent legal personality to state companies after their transformation in commercial societies. It also granted them certain control on their assets and activities. However, limitations remained regarding important decisions. Adopted in 1991, the Regulation nº154 on Decentralisation and Demonopolisation and the Law on Defence of Competition facilitated the partition of state companies and allowed free access to traditionally inaccessible sectors. The Commercial Law of July 1991 allowed the development of new private companies. After that, it became possible for any Bulgarian or foreign individual to set up a company. Eventually, decentralisation progressed with the abolishment of the central planning and the development of the privatisation.
The process of economic liberalisation started up in February 1991. The package of reforms introduced was discussed with the IMF and included the signing of a stand-by agreement. The reforms included stabilisation and liberalisation measures. The liberalisation packages included the reduction of grants and privileged credits to state companies and the liberalisation of the external sector and the prices. Regarding prices, only fourteen first necessity articles were under state control through the fixing of ceilings[52]. Later on, with the advance of the reforms the degree of state control of prices decreased more. Nowadays,

[51] Peev, E. (2002): op.cit.
[52] OCDE (1992): op.cit

according to EBRD[53], the degree of liberalisation of the trade and prices in Bulgaria are the same as in the advanced market economies[54].

3.2. The Effectiveness of Bankruptcy

The Bulgarian legislation on bankruptcy (Part IV of the Commercial Law) was approved in 1994 and later on suffered several modifications. The law applies to all commercial entities, except public monopolies or state-owned companies established by a special law. Bank bankruptcy is regulated by the Law on Bank Bankruptcy. According to the EBRD's 2004 Sector Assessment Survey, the insolvency law receives a score of "High Compliance" and is one of the leading laws in the transition economies[55]. It contains clear criteria of insolvency and a clear scheme of priorities among creditors that protects guaranteed credits and contemplates the possibility of reorganisation of the company. The changes made in 2003 seek to accelerate bankruptcy proceedings and to solve the problem of lack of trained trustees.

However, a wide difference exists between the extensiveness of the legislation and its effective application. The number of bankruptcies is reduced and the liquidation of companies can take several years. In fact, the legislation started to be applied only since 1997 after the changes were applied to the bank system and the liquidation and isolation program of state companies was approved in 1996[56]. The number of bankruptcy proceedings opened in Bulgaria was 494 in 2003 and 208 in 2004, few compared with Czech Rep. (2,234), Hungary (7,519), Romania (3,353) or Croatia (1,738). Moreover, the insolvency rate, defined as the number of bankruptcies compared with the number of active companies, is in Bulgaria 0.06% for 2004, again smaller than Czech Rep. (0.9%), Hungary (1.7%), Romania (0.6%) or Croatia (2.7%)[57].

According to the EBRD Legal Indicator Survey for 2004[58], the effectiveness of insolvency legal regime is low, one of the lowest of all transition countries. The initiation of an insolvency case by creditors or debtors is simple, but the development of the process is complex, expensive, unreliable and unpredictable[59]. World Bank provides concrete indicators on the difficulties for closing a business in Bulgaria. In 2005 the process to resolve a bankruptcy takes 3.3 years (1.5 in the OECD countries) and it costs 9% of the estate value (7.4% in the OECD countries).

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[53] EBRD (2005): *Country Strategy for Bulgaria*. European Bank for Reconstruction and Development, London.

[54] Once prices of coal were liberalised in 2002 the State still controlled the prices for tobacco, water supply, electricity, gas, heating, medicines, postal services and telecommunications.

[55] EBRD (2005): op.cit.

[56] This program consisted on the classification of the state companies in two lists, one of liquidation and another of isolation. The first included 64 companies that represented 29% of the total losses and they would close immediately. The second list included 70 companies that represented 50% of the losses. These last ones would be deprived of new bank credits and discharged temporarily of the service of their payment obligations and they were dedicated to the liquidation or the privatisation. See OCDE (1999): *Études économiques de l'OCDE: Bulgarie*. OCDE, Paris.

[57] COFACE (2005): *Insolvencies Opened in Central and Eastern Europe*. Coface Central Europe, Vienna. (www.cofacecentraleurpe.com, visited 30/12/2005).

[58] EBRD (2004): *Legal Indicator Survey for 2004*. European Bank for Reconstruction and Development, London.

[59] EBRD (2005): op.cit.

The recovery rate, expressed in terms of how many cents on the dollar claimants recover from the insolvent firm, is 33.5 (73.8 in the OECD countries)[60].

The effectiveness of the law depends on its voluntary observance and on the effectiveness of the institutions in charge of enforcing the law[61]. In Bulgaria, the reasons for the passivity of creditors in starting a bankruptcy process are diverse. The first is related to the low value of the assets expected to be receive by the creditor. It is due to the bad conditions of conservation of the assets, to the absence of capital markets able to mobilise buyers for those assets and for the doubts as to the result of the bankruptcy process[62].

A second reason refers to the desire of not discovering the abundance of unproductive assets in the balance of the banks. In the Bulgarian case, this element was especially important until the establishment of the currency board in 1997 and it was possible because of the inefficiency of the bank system supervision and the easy access to refunding by the National Bank characteristic of the first part of the Bulgarian transition. The third cause of the creditor's passivity comes from the existence of privileged relationships among the economic agents[63]. In the Bulgarian case, special relationships exist between banks and companies and, also especially until the 1996 crisis, between the creditors and the State, manifested in the tolerance with the bank irregularities[64].

On the other hand, the inefficiency of the state institutions in charge of the execution of the law indicates the weakness of the Bulgarian State and the deficiencies of the judicial system, linked to staff shortages and low qualifications, low wages and corruption. Most of Bulgarians consider courts as unreliable, inefficient and corrupt. According to an opinion poll conducted among small and medium-scale entrepreneurs only 12% trust the court system[65]. Although there are also some different polls suggesting that corruption is not so widespread. According to the *Business Environment and Enterprise Performance Survey* conduced by EBRD and World Bank[66], the interviewed firms that have had some experience with the court system responded as having little trust in the legal system and seldom or only sometimes considered the judicial system performs well, that is to say, fairly, uncorrupted, fast, affordable, and able to enforce its decisions. The recommendations of EBRD point out the importance of improving the functioning of the judicial system[67].

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[60] World Bank (2006): *Doing Business. Benchmarking Business Regulations*. (http://www.doingbusiness.org/exploreeconomies/default.aspx?economyid=30), visited 14/02/2006.

[61] Mitchell, J. (1993): "Creditor Passivity and Bankruptcy: Implications for Economic Reform", Mayer, C; Vives, X. (eds.): *Capital Markets and Financial Intermediation*. Cambridge University Press, Cambridge.

[62] IMF (2000): *Bulgaria: Selected Issues and Statistical Appendix*, IMF Staff Country Report nº 00/54. IMF, Washington.

[63] Begg, D.; Portes, R. (1993): "Enterprise Debt and Economic Transformation: Financial Restructuring in Central and Eastern Europe", Mayer, C; Vives, X. (eds.): *Capital Markets and Financial Intermediation*. Cambridge University Press, Cambridge.

[64] CEEBIC (1998): *Investment Climate Statement for Bulgaria 1997*. Central and Eastern Europe Business Information Center and U.S. Embassy, Sofia.

[65] Schönfelder, B. (2005): "Judicial Independence in Bulgaria: A Tale of splendour and Misery", *Europe-Asia Studies*, 57, 1.

[66] EBRD and World bank (2002): *Business Enviroment and Enterprise Performance Survey*. EBRD and World Bank, London and Washington. (http://info.worldbank.org/governance/beeps2)

[67] EBRD (2005): op.cit.

4. Financial System

4.1. Privatisation and development of bank system

Until the end of the '80s the Bulgarian banking system was formed by the Bulgarian National Bank (BNB), the Bulgarian Foreign Trade Bank (BFTB) and the State Saving Bank (SSB), according to the traditional pattern of the planned economies banking system. In 1987 a reform led to the creation of eight sector banks. The objective of the reform was the substitution of the monobank system with a two-tier banking system. However, this transformation took place later on, in 1990, when 59 commercial banks were authorised to operate as universal banks, that is to say, with a capacity to offer financing and to capture deposits of any enterprise and individual. These banks were transformed into joint stock companies and, then, a sale process to state enterprises and other banks began. Additionally, private entities also were authorised to acquire shares in a barely supervised process that was abandoned after a year[68]. The privatisation process began without the existence of a regulatory legal framework of banking activities, without an operating capital market and without a law on bankruptcy. The regulatory framework of the bank liberalisation was very permissive and few entry limitations were established. It allowed the creation of banks by groups of interests whose main objective was to obtain privileged financing[69].

In June 1991 a new law on the National Bank was issued. It redefined its functions and conceded considerable independence and the characteristic functions of a central bank in a market economy. Since then, the National Bank has take charge of monetary policy design and of the regulation and supervision of the banking system. Later on, in March 1992 the law on Banks and Credit Activities was issued. It defined the regulatory framework of the activities of banking institutions. The new regulation allowed the BNB to adopt of a very flexible policy regarding the concession of licenses to the banks. This way, numerous banks with very low capitalisation levels began to be established. In this period, in spite of its formal independence, the central bank could not resist the political pressures in the design of the monetary policy. The pressures achieved the expansion of the monetary supply through two channels: the financing of the budget deficit and the financing of the state enterprises through bank credits that the central bank supported by the re-financing of the commercial banks. However, although the central bank regulated the banking system, it had many difficulties in enforcing the accomplishment of the normative. In fact, although the central bank had the ability to concede the opening licenses, it was not able to liquidate the insolvent banks[70]. Another measure that became useless was the creation of the Bank Consolidation Company (BCC), conceived as the institution in charge of consolidating, restructuring and privatising the state commercial banks. The delegation of the

[68] The obscurity of this spontaneous privatisation process was increased by the possibility of transferring shares to other agents later on without any type of registration. See Dilova-Kirkova, S. (1999): "Corporate Governance in Bulgarian State-Owned Banks, 1992-1997", *Post-Communist Economies*, 11, 2.

[69] Tsantis, A. (1997): "Developments in the Bulgarian Banking Sector", OECD (ed.): *The New Banking Landscape in Central and Eastern Europe. Country Experience and Policies for the Future*. OECD, Paris.

[70] Caporale, G. et al. (2001): "The Banking System in Bulgaria", Sevic, Z. (ed.): *Banking Reforms in South-East Europe*. Edward Elgar, Cheltenham.

property rights for the BCC did not allow privatisation to advance[71]. This was in part due to political pressures and to the opposition of bank managers who feared to lose their positions and privileges[72].
At the end of 1995 there were 44 banks, almost all state-owned, with bad solvency ratios, de-capitalised and with high share unproductive assets, making up a highly concentrated sector[73]. Distrust in the bank system became patent at the beginning 1996 when began to take place a massive retreat of deposits on the part of the population and a crisis exploded that led to the closing of a third of commercial banks[74].
In July 1997 a radical monetary reform centred in the introduction of the currency board was established. This reform was framed in a stabilisation program and international assistance negotiated with the International Monetary Fund in April of the same year. The currency board meant the abandonment of the monetary policy. In fact, the central bank no longer carries out the functions of refinancing the commercial banks, financing the public budget, developing the exchange policy or directing open market operations[75]. In 1997 a new law on the National Bank was issued. The objective was to reinforce the control on the money supply and regulation and supervision mechanisms. The new law established stricter exigencies for the commercial banks with reference to minimum capital, liquidity and classification of assets
After these changes the privatisation process and the entry of foreign capital into the bank system was intensified. The sale of banks to foreigners was already almost completed in 2000. The National Bank of Greece bought 90% of the UBB, which was already privatised previously to a consortium of investors, and Bulbank was sold to Italian Unicredito that bought a participation of 93%[76]. Later on, in 2003, the last two big banks, Biochim Bank and State Saving Bank, were sold. In

[71] Example of bank consolidations are the creation of the Union of Bulgarian Banks at the end of 1992, through the merger of 22 small banks, and the creation of Expressbank, through the union of 12 banks. Another example is the acquisition of Sofiabank by Biochim in 1995. The attempts of consolidation carried out by the BNB through the increase of the capital minimum requirements did not give results. See Caporale et al. (2001): op.cit.
[72] Dilova-Kirkova, S. (1999): op.cit.
[73] Around 65% of the assets were state property. The obstacles to the entrance of foreign banks explain that only exist 4 foreign banks that represented around 5% of the assets. The 7 bigger banks had a quota of market of 75% of assets. The profitability/assets was very low, around 0.8%, and the capital/risk assets ratio was also reduced, around 5%. See Ulgenerk, E.; Zlaoui, L. (2000): *From Transition to Accession*. *Developing Stable and Competitive Financial Markets in Bulgaria*. World Bank Technical Paper nº 473. World Bank, Washington.
[74] Balyozov, Z. (1999): *The Bulgarian Financial Crisis of 1996-1997*. Discussion Papers nº 7/1999. Bulgarian National Bank, Sofia.
[75] This mechanism is composed of a set of rules foreseen to cover 100% of the reserve money with liquid foreign assets. An exchange rate anchored to a convertible foreign currency, in this case the German mark (DM), was settled with the central bank which changes any quantity of leva against the reserve currency to the fixed type (1,000 leva for 1 DM). In the Bulgarian case, a deposit created by the surplus foreign reserves on the monetary reserve would allows the BNB to refinance the commercial banks in emergency cases. This special mechanism allows to qualify the Bulgarian currency board as non orthodox case. See Nenovsk, N. and Hristov, K. (2001): “The Nonorthodox Currency Boards: the Case of Bulgaria”, *Papers Transició*, 2.
[76] Bonin, J. P. (2004): “Banking in the Balkans: the Structure of Banking Sectors in Southeast Europe”, *Economic Systems*, 28.

2003 there were 35 banks, of which 25 are foreign-owned. Of the remaining ten, only two small banks are state-owned[77].
The financial system is dominated by the banking. The bank system represents 90% of total financial sector assets. As the IMF points out, the bank sector presents high capitalisation, profitability and liquidity levels[78]. The system is supported by a solid legal and supervisory framework and by the existence of a nucleus of highly capitalised and liquid big banks, mostly foreign owned, that represent 75% of the assets, deposits and capital of the bank sector. The banks are highly capitalised, with a capital adequacy ratio of 22% in 2003. The profitability is high and the return on assets is 2.4% while the return on equity is 21.7%[79].

4.2. Stock market and other financial institutions

The Bulgarian financial system is broadly dominated by banking. Other financial institutions such as capital markets, insurance companies, investment funds or pension funds only began to develop since 1997. The non bank financial sector continues being a very reduced part of the financial system, less than 8% of the total assets. It is made up of 31 insurance companies representing 4% of total assets, 8 pension fund companies with 2.6% of assets, 67 securities firms (1% of assets) and many small finance companies and collective investment schemes[80].
The Bulgarian Stock Exchange (BSE) was created in 1997 from the consolidation of several stock markets that proliferated in the 90s. Although the number of companies registered on the stock market is relatively high, many of the shares are property of the State and they are not available for negotiation. The BSE began to grow in 2003 and its evolution has been closely linked to the privatisation of the state companies. Nevertheless, the level of development of the stock market is very reduced. The turnover on BSE was 133.8 millions leva in 1999, 416.4 in 2002 and 688.4 in the first nine months of 2003. The number of listed companies on the official market is 35, almost the same than in 1999, and the stock exchange capitalisation ratio was 4.8% in 2000 y and 7.9% en 2003.
These indicators point out the inability of the stock market to provide financing to the real sector. The great majority of the companies have been negotiated very few times and they show little interest in participating in the market. In Bulgaria, the participation of companies in the capital market has its origin in the mass privatisation program and not in a desire to increase capital. On the other hand, the directors of the companies don't perceive benefits from trading on the stock exchange, while they observe important costs[81]. The other institutions of the financial system, such as insurance companies or pensions funds are less developed. The role of the insurance sector as lender, and borrower, is very

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[77] BNB: *Annual Report*. Bulgarian National Bank, Sofia. Different issues.
[78] IMF (2004): *Bulgaria: Selected Issues and Statistical Appendix*, IMF Staff Country Report nº 04/117. IMF, Washington.
[79] BNB: op.cit. IMF (2004): *Bulgaria: Selected Issues and Statistical Appendix*, IMF Staff Country Report nº 04/117. IMF, Washington.
[80] IMF (2004): op.cit.
[81] The company should provide wide information on its activities. The public declaration of activities of the company is expensive and it hinders the administration of the company in function of the managers' personal interests.

reduced and it represents less than 2% of the bank credit to the private sector in 2003[82].

4.3. Monetisation and bank credit

In the period prior to the 1996 bank crisis and the establishment of the currency board, the central bank was unable to resist the political pressures in the design of monetary policy. The expansion of money was explained by the funding of public deficit and the support to state companies through bank credits that the central bank fed by refunding commercial banks. This way, up to 1996, the monetisation level measured as M2/PIB oscillated around 50-60%. On the other hand, the volume of domestic credit was high, above 100% of the GDP, and was dedicated mainly to finance the State and the state companies[83].

The origin of the problem of unproductive loans in the first years of transition was the credits granted to the state companies during the planning economy period. However, the problem increased during the transition with the new loans from state banks to state companies and from private banks to the new private companies[84]. Besides reasons of technical type, such as the faulty accounting systems or deficiencies in the specialists' skills[85], the bad loans problem shows a net of interests and privileged relationships between directors of companies and banks and a high volume of loans to the insider agents of the banks. The magnitude of the unproductive credits was considerable; in fact the standard percentage of credits only reached 7% in 1993 and 25% in 1995, the rest being unproductive credits.

Immediately after the installation of the currency board in 1997, the monetisation level (M2/PIB) of the economy decreased considerably until 30%, reaching 47.6% in 2003[86]. This is a very reduced level compared with the western market economies. Domestic credit also diminished abruptly since 1997 to below 20%. Mid 2002 significant growth in credit took place, recovering from the very low post-crisis levels and reaching a 27.6% GDP in 2003. This growth has concentrated especially on credits to private companies and households, while the credit to non-financial public corporations has diminished 0.5% annually in the period 1998-2003, a process linked to the privatisation of the state companies[87]. The bank credit structure reflective the reorientation of lending toward the private sector. At the end of 2003, the share of private corporations' total credit is 70%, the share of households is 27% while the share of the non-financial public corporations is only 2.5%[88]. In any case, the total volume of credit is very reduced compared with the

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[82] IMF (2004): op.cit

[83] BNB: op.cit. The 65% was bank credit to the Budget, 15% was credit to public companies and 20% credit to the private companies. See EC (2003b): *The financial sector in Bulgaria*. Directorate General for Economic and Financial Affairs. Commission of the European Communities, Brussels.

[84] It is necessary to remember that the problem of the unproductive credits was not only a question between state banks and state companies. In the private banking, only 39% of the loans were regularly served. See Yonkova, A. et al**.** (1999): "Development of the Banking Sector in Bulgaria", IME (ed.): *Banking Sector Management under Currency Board*. Institute for Market Economics, Sofia.

[85] Ignatiev, P.; Simeonov, R. (1999): "Structuring and Conduct of Bank supervision in Bulgaria", IME (ed.): *Banking Sector Management under Currency Board*. Institute for Market Economics, Sofia.

[86] BNB: op.cit.

[87] IMF (2004): op.cit.

[88] IMF (2004): op.cit.

levels around 100% of GDP characteristic of the Eurozone countries. Unproductive loans also have been reduced significantly. In accordance with the new criteria of classification of unproductive loans[89], the percentage of standard credits increased to 58% in 1997 and to 92.7% in 2003. Classified loans, i.e., loans past due over 31 days, represent 7.3% in 2003[90].

5. Conclusions

An approach from the institutionalism of Polanyi allows us to deepen the analysis of the degree of creation of exchange relationships. This analysis has been made possible thanks to the definition of an evaluation mechanism of economic policy reforms that pursues the creation of a market economy in a transitional context.

The degree of accomplishment of the marketisation criteria determines to what extent a market of the means of production has been institutionalised. The first condition demands the exchange of the means of production be possible. The privatisation process is practically concluded. The recognition of private property and the privatisation process developed in Bulgaria have allowed most of the domestic production to come from private agents. In consequence, the first condition has been fulfilled.

The second condition requires that the price of the means of production is determined in the framework of the exchange. The suppression of planning, the decentralisation measures and the development of the private sector, on one hand, and the liberalisation of prices, on the other, facilitate the determination of price in the sphere of the exchange. In consequence, the second condition is also completed.

The third condition demands that the price auto-regulates the exchanges and that the use of the means of production depends on its profitability. In the first years of the transition the question of the bankruptcy did not constituted a priority in the reforms. Only since the second half of the 90s did a complete legislation on bankruptcy appear. However, its effectiveness is limited and the number of closures and liquidations of companies are reduced, in spite of the high number of companies with financial difficulties. The reasons behind this reduced effectiveness of the legislation are related to the economic agents' behaviour, reacting passively to the new institutional universe and to the inefficiency of the State. In consequence, obstacles exist to the assignment of resources being determined by their profitability and to the imposition of financial discipline in its use. Concretely, it doesn’t guarantee the liberation of resources used in non profitable uses and their incorporation into the supply, allowing the existence of enterprises independently of their profitability.

The Bulgarian financial system is little developed and dominated by the banking. The capital market is very under-developed and, given its reduced activity, is unable to provide funding to the real sector and to assign value to assets. The bank system presents a low level of monetisation and intermediation and it is very concentrated. Bank credit to the real sector is scarce. Summing up, the financial

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[89] The classification of the risk of credits and their denomination has changed along the transition. During the period 1993-1996, standard credits were those served without back payments. See BNB (1995): *The Bulgarian Banking System*. Bulgarian National Bank, Sofia. Since 1997 credits with back payments that before were classified as doubtful type A they are now considered standard.

[90] BNB: op.cit.

system shows limitations in the function of monetising the economy, in the canalisation of financial resources for the demand and use of the means of production and in the linking of their value to the profitability. In consequence, the third condition is not completed. Therefore, the reforms implemented in the Bulgarian transition have not resulted in the complete development of a market for the means of production, just as this has been defined.